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LDP Begins Selection Process For New Prime Minister

The ruling Liberal Democratic Party, anxious to stabilize the domestic political situation and restore the public's faith in its leadership capabilities, has set selection by secret ballot of its new president for an August 8 joint plenary session of its 403 Diet members. Toshio Komoto, the 78-year-old leader of one of the LDP's smaller factions, and Toshiki Kaifu, 58, a former education minister and Komoto lieutenant, appear to be the leading contenders to succeed Sosuke Uno as party leader and therefore prime minister. Mr. Uno, whose 52-day administration was crippled by the Recruit Co., Ltd. influence-peddling affair, opposition to the new consumption tax and allegations of his

Many market watchers question whether consumers will take to the new format, especially in light of initial price tags of $1,300 and up. Many also question the effectiveness of the antipiracy agreement, pointing out that it would permit endless production of perfect DAT tapes from CDs. Ironically, the Japanese recording industry has denounced the agreement precisely because of this inadequacy. The Japan Phonograph Record Association, the Japanese Society for Rights of Authors, Composers and Publishers and the Japan Council of Performers' Organizations said that the limitation of DAT tapes to first-generation copies was not an effective safeguard for the copyright holders. Observers around the globe predict that a levy on each DAT machine and blank tape eventually will be applied to compensate artists and music companies.

From another perspective, the success of DAT could pose problems for U.S. trade policy. Since no American manufacturer currently makes DAT equipment, all the machines must be imported. If they prove to be as popular as CDs and VCRs, DAT machines could add significantly to the U.S. import bill. Conversely, those seeking to revive the U.S. consumer electronics industry may seize on DAT to complement their plans to create a domestic high-definition television industry.

Jon Choy

Extension Of U.S. Steel Quotas Puts Japan's Mills In Bind

President Bush's July 25 decision to extend the quotas on imports of foreign steel for 30 months while trying to negotiate an end to subsidies and barriers that distort world trade in steel was hailed as a reasonable compromise by major American steel users but denounced as shortsighted by domestic steel producers and their allies on Capitol Hill. Japanese steel mills had little to say about the White House announcement, even though they had a lot riding on whether the administration opted to continue the restraint arrangements initiated by President Reagan in September 1984 or to allow the quotas to lapse at the end of the original five-year program. But the Japanese industry's reticence did not come as a complete surprise since the world's largest steel manufacturers and exporters had adopted a low profile during the increasingly heated domestic debate over the future direction of U.S. steel trade policy.

Cynics claimed that Japan's steel suppliers could afford to stay on the sidelines this time around since an influential coalition of 200-plus American steel customers led by Caterpillar Inc. was challenging the U.S. steel industry's assertion that it needed another five years of protection from foreign competition. Some American steel executives and trade analysts proposed a different rationale for Japan's seemingly disengaged position. Japanese mills, they charged, were dumping steel in the United States and therefore were afraid to lobby actively for unrestricted access to the American market. In reality, steelmakers in Japan were reluctant to enter the fray because they recognized they could benefit either from extended quotas or from a September 30 end to the restraint program.

On the one hand, an end to Washington's voluntary restraint agreement with Tokyo might enable Japanese exporters to ship more steel to this country. U.S. purchases of Japanese-made steel mill products dropped 35.3 percent between 1984 and last year (see Table). Most of this cutback can be traced directly to the restraint program, which covers almost all of Japan's U.S.-bound

Apparent U.S. Consumption of Steel Mill Products, 1984-88

(in thousands of tons)

	1984	1985	1986	1987	1988
Domestic Shipments	73,740	73,043	70,263	76,654	83,841
Total Imports	26,163	24,256	20,692	20,415	20,891
Total Exports	980	932	929	1,129	2,069
Apparent Consumption	98,922	96,367	90,026	95,940	102,662
Total Import Market Share	26.4%	25.2%	23.0%	21.3%	20.3%
Market Share for VRA Countries	21.9	20.5	17.4	14.7	14.5
Total Imports from Japan	6,630	5,990	4,422	4,321	4,290
Japan's Market Share	6.7%	6.2%	4.9%	4.5%	4.2%

carbon steel exports. In 1988, however, Japanese exporters were able to fill only 72.1 percent of their aggregate quota. This shortfall was partly a byproduct of record steel demand at home and continued industry downsizing, but it also reflected the fact that Japanese steelmakers were the high-cost competitors in the American market last year.

According to estimates prepared in late 1988 by PaineWebber Inc. steel analyst Peter F. Marcus, at an exchange rate of Y125=$1.00 (which was slightly higher than the average for the year), the landed U.S. cost of Japanese-made cold-rolled sheet was $632 per metric ton -- $148 more than the comparable American product and $87 above sheet supplied by West German mills, which had the second-highest landed cost. Japanese exporters were at a similar disadvantage across-the-board but especially in commodity products.

While the steep run-up in the yen's value since 1985 has forced Japanese producers to shift output increasingly to high value-added steel like coated sheet and stronger but lighter products, the way the U.S. quota is structured restricts the ability of Japan's industry to alter the mix of export products to minimize its cost handicap in the American market. Not only are overall imports from Japan capped but there also are limits on all major product categories -- sheet and strip, plate, structurals, bars, pipe and tubing, wire rod and wire products, finished structurals and semifinished products -- and on key product groups within each category. Exporters have some freedom to change the mix of categories subject to quota and to switch shipments of products within a category, but the flexibility built into the present VRA does not fully reflect the international cost position of Japan's steel industry.

Although they might be able to sell more steel here if the market were wide open, steelmakers in Japan see some pluses in the continuation of the U.S. steel restraint program. For one thing, the quota arrangement has eliminated a major source of friction in the bilateral relationship. Japanese producers understandably do not want a replay of the disruptive trade battles of the 1970s and early 1980s. The VRA also provides Japan's industry as well as other participants in the restraint program immunity from dumping and other trade complaints. One of the primary lobbying tactics used by U.S. steel manufacturers over the last year or so was to threaten to flood the government with unfair

trade practices cases if the quota plan expired. Moreover, even though Japanese mills could not fill their quota last year and probably will come in below target in 1989, extension of the ceiling plays a defensive role for Japan's industry: it limits the U.S. market inroads of other offshore suppliers while keeping the door open for Japanese exporters should market conditions change at home or demand in third countries weaken.

President Bush and his senior economic advisers had to juggle a longer list of pros and cons in deciding the fate of the expiring steel restraint program, including the increased competitiveness of the U.S. industry and its improved financial health and the possibility that domestic producers might be sent reeling again when the next cyclical downturn in demand hits. In the end the cabinet compromised. It extended the quotas that currently limit imports of finished carbon steel products from Japan, the 12-member European Community and 17 other VRA countries to 18.4 percent of apparent U.S. consumption for 30 months. That transitional period will be used to forge an international consensus on a long-term solution to government intervention in the steel sector, which the White House fingered as the primary cause of worldwide overcapacity in steel and, by extension, the painful adjustments U.S. steel manufacturers must make in periods of soft global demand. But even if a consensus is not reached by March 31, 1992, Mr. Bush said, the quotas still will end.

To facilitate the return to an open American steel market, Washington will add several new twists to the current restraint arrangements. Most notably, the overall ceiling on finished products imported from VRA countries will be raised by 1 percentage point a year or to 20.9 percent of apparent consumption by the time the cap is lifted. In addition, the restraint level on semi-finished steel, now a fixed quantity, will change automatically in response to domestic demand -- a wrinkle designed to alleviate the repeated problems nonintegrated mills have experienced in getting an adequate supply of slab. At the same time, the existing mechanism for obtaining short supply relief will be expedited and streamlined.

The increases in the import ceiling under the new restraint program will be allocated on a first-come, first-serve basis to VRA countries willing to end trade-distorting steel subsidies and to remove tariff and nontariff barriers to steel imports. Given these criteria, Japanese producers, which now have the largest quota allocation -- 5.8 percent of American demand, should be in line for a bigger allotment. Although there has been talk in U.S. steel industry circles about Japanese dumping, no one in recent years has accused Tokyo of subsidizing domestic steelmakers or providing other financial support to them. Moreover, Japan's steel imports are soaring at the same time that its exports are dropping. Purchases of foreign steel jumped 38.6 percent last year on top of a 1987 gain of 50 percent-plus, which boosted the import share of apparent consumption to 8.4 percent. Most of these inroads have been made by South Korea, Taiwan and Brazil in the commodity end of the market.

Despite this favorable outlook, Japanese steel exporters are running scared. They are afraid that Washington will try to cut their quota since shipments came in so low last year. In talks with their American counterparts expected to begin shortly, Japanese trade negotiators no doubt will pull out all the stops to get the best deal possible. In addition to emphasizing the country's clean record on subsidies and import barriers, the Japanese team also

can be expected to highlight the technological and financial contributions mills in Japan have made to U.S. steelmakers in recent years. These include two production tie-ups in this country between Nippon Steel Corp. and Inland Steel Industries Inc., similar arrangements between Sumitomo Metal Industries, Ltd. and LTV Corp., the Kobe Steel, Ltd.-USX Corp. venture recently formed to operate the top American steel company's bar facility, NKK Corp.'s 50 percent interest in National Steel Corp. and Kawasaki Steel Corp.'s recent $350 million investment in Armco Inc. Japanese government officials and industry executives are banking on relationships such as these to protect their current access to the U.S. market.

Susan MacKnight

Notes

Mexican Debt Plan - Mexico reached agreement July 23 with its bank creditors on a debt restructuring format that has become the first concrete result of the Brady Plan announced in March by Treasury Secretary Nicholas Brady. As widely expected the banks are given three rather unpleasant choices: they may opt for a 35 percent reduction in the outstanding principal of their loans to Mexico, accept a reduction in the interest charged to 6.25 percent from floating rates currently higher than 10 percent or extend additional loans.

Officially, Tokyo was enthusiastic. Finance Minister Tatsuo Murayama told a press conference, "It's a good development." The Brady Plan borrows some elements of a 1988 proposal floated by Japan that became known as the Miyazawa Plan after former Finance Minister Kiichi Miyazawa. In contrast, Japanese banks, which collectively rank second behind U.S. banks as top lenders to Mexico, were said to be critical. The banks hold $9 billion of the $54 billion total in bank loans outstanding to Mexico. They were reported to be feeling that an across-the-board 35 percent reduction in principal was unacceptable. Partly for this reason, Japanese banks responsible for most of the lending were said to be leaning toward accepting the lower interest rate option.

FSX - As generally expected, President Bush vetoed legislation July 31 that would have imposed additional conditions on U.S. participation in the joint development and production of Japan's next-generation fighter support aircraft, FSX. The White House in early June gave General Dynamics Corp., the main U.S. subcontractor, the green light to begin the development phase of this project with Mitsubishi Heavy Industries, Ltd., the prime Japanese contractor, since both houses of Congress had not passed a resolution of disapproval by May 31 to block the deal (see JEI Report No. 23B, June 16, 1989). However, the president's most recent action apparently lays to rest any concerns that there might be changes in the conditions agreed on by the two governments in the November 1988 memorandum of understanding and the April 1989 side letters governing the FSX project.

The legislation, which passed the Senate and House on May 16 and June 7, respectively, would have required that "no less than 40 percent" of both the development and the production work go to U.S. companies as well as at least 40 percent of the spare parts work. It also would have prohibited the transfer to